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In The

Supreme Court of the United States

October Term, 1991

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
Respondent.

*On Petition for Writ of Certiorari to the United States Court
of Appeals for the Fifth Circuit*

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether Congress intended, when it enacted the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.*, to prohibit employers from contributing any property other than cash to their defined benefit pension plans?

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No. 91-1677

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Respondent.

*On Petition for Writ of Certiorari to the United States Court
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RESPONDENT'S BRIEF IN OPPOSITION**STATEMENT OF THE CASE**

The issue in this case is whether Congress intended, when it enacted the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq.*, to prohibit employers from contributing any property other than cash to their defined benefit pension plans. Petitioner argues that a contribution of noncash

property is a "prohibited transaction" because § 4975(c)(1)(A) of the Internal Revenue Code (the "Code"), 26 U.S.C. § 4975, prohibits any "sale or exchange" of property between a disqualified person (such as an employer) and a qualified pension plan. With no authority other than an analogy to income tax rules, petitioner argues that Congress intended for any contribution of noncash property to be treated as a "sale or exchange." Respondent acknowledges that there is a conflict on this issue between the decision of the United States Court of Appeals for the Fifth Circuit in the case at bar (reported at 951 F.2d 76 (CA5 1992), *aff'g*, 60 T.C.M. (CCH) 1423 (1990)), and the decision of the United States Court of Appeals for the Fourth Circuit in *Wood v. Commissioner* (reported at 955 F.2d 908 (CA4 1992), *rev'g*, 95 T.C. 364 (1990)).

The *Wood* and *Keystone* cases have progressed through the federal courts almost simultaneously. The Tax Court's decision in *Wood* was issued on September 27, 1990. In that decision, the Tax Court ruled that if Congress had intended to prohibit noncash contributions of property, it would have expressed that intention in plain language, rather than through an oblique reference to a "sale or exchange." Approximately two months later, on December 13, 1990, the Tax Court in *Keystone* issued a separate decision, granting *Keystone*'s motion for summary judgment for reasons similar to those articulated in *Wood*.

The Commissioner appealed both decisions. Oral argument in *Wood* was held in the Fourth Circuit on October 1, 1991. Oral argument in *Keystone* was held in the Fifth Circuit on November 5, 1991. On January 17, 1991, the Fifth Circuit affirmed the Tax Court decision in *Keystone*, holding that Congress did not intend for a transfer of unencumbered property to be a prohibited "sale or exchange." Two weeks later, on January 31, 1991, the Fourth Circuit reversed the Tax Court decision in *Wood*, holding that the income tax definition of a "sale or exchange" should be applied

to the excise tax provisions enacted as part of ERISA, and that a contribution of property thus should be treated as a prohibited "sale or exchange."

REASONS FOR DENYING THE WRIT

Petitioner seeks a writ of certiorari so that this Court can resolve the conflict between the Court of Appeals for the Fourth and Fifth Circuits in *Wood* and *Keystone*. While there is a conflict between these two decisions, it would be imprudent at this time for this Court to resolve the conflict.

1. When Congress enacted § 4975 in 1974 as part of ERISA, authority to issue regulations under § 4975 rested with the Department of Treasury. The Department of Treasury never exercised its authority to issue or propose those regulations. In 1978, regulatory authority was transferred from the Department of Treasury to the Department of Labor (the "DOL"). Section 102 of Reorganization Plan No. 4 of 1978, 92 Stat. 3790. In the fourteen years since that transfer of authority, the DOL has not issued or proposed regulations.

Shortly before the transfer of authority to issue regulations under § 4975 to the DOL, an employer sought a private ruling from the Internal Revenue Service (the "IRS") that the contribution of a third-party promissory note from the employer to its defined benefit pension plan was not a prohibited transaction within the meaning of § 4975(c)(1). The IRS responded that the issue was *not* resolvable without regulations:

[T]he question of whether the contribution of property other than cash by an employer to his plan constitutes a prohibited transaction as defined by section 4975(c)(1) of the Code, presents an issue that cannot reasonably be resolved prior to the

issuance of regulations. Since regulations interpreting section 4975(c)(1) of the Code have not yet been promulgated, the Service is unable to issue a ruling as requested at the present time.

Private Letter Ruling 7852116 (Sept. 29, 1978).

Although regulations have never been issued or proposed, the Commissioner now asks this Court to resolve the question that the IRS previously asserted "cannot reasonably be resolved prior to the issuance of regulations." Respondent submits that it would not be a prudent use of this Court's resources to address an issue which might be resolved simply by the DOL's exercise of its regulatory authority.¹

2. Respondent acknowledges that the decisions in the case at bar and in *Wood v. Commissioner* are in conflict. The facts under which this conflict arose, however, are unusual, and present less than compelling circumstances for this Court to resolve the conflict without further analysis from other courts of appeals.

Although § 4975 was enacted as part of ERISA in 1974, only recently did the IRS begin asserting that a contribution of property other than cash to a defined benefit pension plan was a prohibited transaction. As late as 1988, the Internal Revenue Manual, an

1. In an amicus brief, the Pension Benefit Guaranty Corporation (the "PBGC"), a corporation established within the DOL and whose Chairman of the Board is the Secretary of Labor, argues that contributions of noncash property should be prohibited in order to prevent valuation abuses. *Keystone*, however, should not be asked retroactively to bear the burden of a penalty tax because the DOL failed, either from oversight or malaise, to issue regulations. Moreover, the PBGC fails to cite any authority or precedent that suggests Congress enacted § 4975 to address valuation abuses, and ignores the other excise tax provisions that impose penalties on employers who fail to fund their pension plans adequately. See, e.g., § 4971 of the Code.

internal IRS handbook that is available to the public, stated that such a contribution was not a prohibited transaction unless the terms of the particular pension plan required cash contributions:

Contributions are generally required to be made in cash. If the Plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, if the Plan permits a contribution to be made in cash or in kind, no prohibited transaction would occur.

Internal Revenue Service Manual, Examination Guidelines Handbook, H.B. 7(10)(54) § 320, 324(2) (July 15, 1988). Prior to the litigation in *Wood* and *Keystone*, the IRS had many opportunities to litigate this issue but, for whatever reason, chose not to do so. See, e.g., *Lambos v. Commissioner*, 88 T.C. 1440 (1987) (employer contributed property to a plan and then leased it back; Commissioner argued, and court agreed, that the leaseback, not the contribution, was a prohibited transaction); *Busch v. Commissioner*, 45 T.C.M. (CCH) 772 (1983), *aff'd*, 728 F.2d 945 (CA7 1984) (employer contributed noncash property to plan; Commissioner challenged deduction for the contribution under § 404 of the Code, but did not raise any issue under § 4975). Consequently, even though Section 4975 was enacted in 1974, the issue presented in this case is a relatively new one.

When the IRS finally decided that it should litigate this issue, the *Wood* case and the case at bar proceeded through the federal courts almost simultaneously. At the time of briefing and oral argument in *Wood*, therefore, the Court of Appeals for the Fourth Circuit did not have the benefit of the Fifth Circuit's decision in *Keystone*. Indeed, the decision in *Wood* was issued only two weeks after the decision in *Keystone*, suggesting that much of the critical deliberation in *Wood* occurred before *Keystone* was

decided. Given these circumstances, where the cases creating the conflict are decided at almost exactly the same time, this Court will benefit from the views of other courts of appeals. Such review, in fact, might well eliminate any need for this Court to consider the issue.

3. Perhaps because *Keystone* had not been decided when *Wood* was briefed and argued, the Fourth Circuit in *Wood* committed several patent legal errors and/or oversights. These errors highlight why this Court should not hear this issue without additional input from other courts of appeals. For example:

a. Seeking to bolster its analysis by reference to administrative interpretations, the Fourth Circuit, citing Rev. Rul. 80-140, 1980-1 C.B. 89, stated that “the IRS has applied the generally accepted definition [of a “sale or exchange”] to the ‘sale or exchange’ language of § 4975 and has construed the transfer of property in satisfaction of a sponsor’s statutory funding obligation as a sale or exchange.” 955 F.2d at 913. This is incorrect. The issue in Rev. Rul. 80-140 was whether it was a prohibited transaction for an employer to contribute its own promissory note in satisfaction of a funding obligation. In this Court’s decision in *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 n.11 (1977), the Court had noted that it was a prohibited transaction under Code § 4975(c)(1)(B), *not* § 4975(c)(1)(A), for an employer to issue its own promissory note in satisfaction of a funding obligation. This Court’s conclusion was based upon the language of § 4975(c)(1)(B), which prohibits any loans between a pension plan and an employer, and the legislative history of ERISA, where both the Senate and Conference Reports stated unambiguously that it would be a prohibited transaction under § 4975(c)(1)(B) for an employer to fund its obligations with its own promissory note. S. Rep. No. 383, 93d Cong., 1st Sess. 98 (1973); H.R. Conf. Rep. 1280, 93d Cong., 2d Sess. 308 (1974). The IRS cited *Don E. Williams* in Rev. Rul. 80-140, and said

nothing at all about a “sale or exchange” under § 4975(c)(1)(A).²

The court in *Wood* cited Rev. Rul. 80-140 on its own initiative — the Commissioner did not cite Rev. Rul. 80-140 in any of its briefs in *Wood* or *Keystone*, and the Commissioner did not cite it in its petition for certiorari here. As the Fifth Circuit correctly noted, the only place where the IRS has taken the position that an employer’s contribution of property is a prohibited “sale or exchange” under § 4975(c)(1)(A) is here and in the *Wood* litigation. 951 F.2d at 79.

b. An employer’s contribution of property to pension plan is a “sale or exchange” only if Congress intended to import the income tax definition of a “sale or exchange” into ERISA’s prohibited transaction rules. In language of paramount importance to this case, § 4975(f)(3) of the Code amplifies § 4975(c)(1)(A) by stating that a transfer of property by an employer to a plan “shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien” As the Fifth Circuit and Tax Court correctly noted, § 4975(f)(3) demonstrates that Congress did not intend for a transfer of unencumbered property to be a prohibited “sale or exchange.” The Fourth Circuit, however, thought that Congress enacted § 4975(f)(3) “to expand the definition of ‘sale or exchange’ as generally understood to include *all transfers* to a plan of *encumbered* property, whether or not in discharge of a debt” 955 F.2d at 913 (emphasis in original). The Fourth Circuit thus assumed that a transfer of property in satisfaction of a funding obligation is a “sale or exchange” under general income tax rules, but that a voluntary

2. If Congress viewed the transfer of noncash property to a plan as a prohibited “sale or exchange” under § 4975(c)(1)(A), Congress would not have said that a transfer of a promissory note was a prohibited transaction under § 4975(c)(1)(B). Nothing in the legislative history states that a transfer of noncash property would be a prohibited transaction under § 4975(c)(1)(A).

transfer is not a "sale or exchange" under those same rules.

The Fourth Circuit must have been unaware that *all* transfers of property from an employer to a plan, *whether voluntary or in satisfaction of a debt*, are treated as "sales or exchanges" under the income tax laws, and were so treated long before ERISA was enacted. See, e.g., *Tasty Baking Co. v. United States*, 393 F.2d 992, 995 (CtCl 1968); *A.P. Smith Mfg. Co. v. United States*, 364 F.2d 831, 838 (CtCl 1966), *cert. denied*, 385 U.S. 1003 (1967); *United States v. General Shoe Corp.*, 282 F.2d 9, 12 (CA6 1960), *cert. denied*, 365 U.S. 843 (1961); *International Freightling Corp. v. Commissioner*, 135 F.2d 310 (CA2 1943); Rev. Rul. 75-498, 1975-2 C.B. 29. Because voluntary transfers of property have been treated as "sales or exchanges" under the income tax laws for many years, the Fourth Circuit's conclusion that § 4975(f)(3) was intended to "expand" the income tax definition of a "sale or exchange" to voluntary transfers of mortgaged property makes no sense.³ Voluntary transfers have always been within the so-called "income tax definition" of a "sale or exchange."

3. The legislative history of ERISA expresses a concern that employers would disguise a "sale or exchange" by putting a mortgage on property and then contributing it to a pension plan:

[A] transfer of property by a party in interest to a trust is treated as a sale or exchange if the property is subject to a mortgage or similar lien which the party in interest placed on the property within 10 years of the transfer to the trust, or if the trust assumes a mortgage or similar lien placed on the property prior to transfer. *This rule prevents circumvention of the prohibition on sale by mortgaging the property before a transfer to the trust.*

S. Rep. No. 383, 93d Cong., 1st Sess. 98 (1973) (emphasis supplied); see also H.R. Conf. Rep. 1280, 93d Cong., 2d Sess. 308 (1974). Section 4975(f)(3) was enacted to prevent this practice.

c. The Fourth Circuit's fundamental error was to fail to recognize that § 4975 was enacted in 1974 as part of ERISA, and was not enacted pursuant to an analysis or review of the income tax laws. Under the income tax laws, as the Fifth Circuit noted, transfers of property from an employer to a pension plan, both voluntary and involuntary, are treated as "sales or exchanges" in order to ensure that the employer's economic income is accurately measured. 951 F.2d at 79. Where the transferred property is subject to a mortgage, the amount of the mortgage is included in the transferor's "amount realized" from the "sale" and the transferee includes the amount of the mortgage in its basis. 26 C.F.R. § 1.1001-2(a)(1); *Commissioner v. Tufts*, 461 U.S. 300 (1983). For that reason, if Congress intended to incorporate the income tax definition of a "sale or exchange" into § 4975, § 4975(f)(3) is superfluous because a "voluntary" contribution of mortgaged property clearly is a "sale or exchange" under the income tax rules.

In contrast to the policy behind the income tax rules, Congress enacted § 4975 as part of ERISA to describe specific identifiable transactions that would be per se "prohibited" and subject to a penalty tax. If Congress had intended to prohibit noncash contributions when it enacted ERISA, the words "sale or exchange" are not the words it would have chosen. Congress would have used the words "contribution" or "transfer."⁴

Although petitioner asserts that there is only one "general" definition of a "sale or exchange," the words "sale or exchange" have many different meanings, depending on the statute at issue

4. Compare § 4975(c)(1)(D), which makes it a prohibited transaction for a plan to "transfer" property to an employer, but imposes no prohibition on an employer "transferring" property to a plan. See also § 408(a)(1), which states, regarding individual retirement account contributions, that "no contribution will be accepted unless it is in cash."

and the legislative history of that statute. *Helvering v. Hammel*, 311 U.S. 504, 507 (1941). In *United States v. Davis*, 370 U.S. 65 (1962), this Court held that a *voluntary* transfer of property pursuant to a divorce agreement was to be treated as a "sale or exchange" for income tax purposes, even though the same transaction was *not* treated as a "sale or exchange" under the gift and estate tax statutes. The Court stated that "[i]n interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes." 370 U.S. at 69 n.6. There is likewise no policy or analytical reason why the income tax definition of a "sale or exchange" should apply for purposes of ERISA, which is even less analogous to the income tax laws than are the estate and gift tax statutes.

CONCLUSION

For the reasons stated above, the Commissioner's petition for a writ of certiorari should be denied.

Respectfully submitted,

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